

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Corbett Analyst: Kimberly Pantoja Bill Number: AB 694
Related Bills: See Legislative History Telephone: 845-4786 Introduced Date: 02/22/2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Provided Health Insurance Premiums Credit/Small Businesses

SUMMARY

This bill would create a tax credit for small employers that provide health coverage to their employees.

PURPOSE OF THE BILL

According to the author's staff, the intent of the bill is to utilize the income tax system to encourage small employers to provide health care coverage to their employees.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective upon enactment. However, this bill specifies that it would be operative for taxable years beginning on or after January 1, 2002, and before January 1, 2008.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are provided to address the department's technical concerns. Department staff is available to assist with amendments to resolve the implementation concerns described below.

ANALYSIS

FEDERAL/STATE LAW

Under federal law, to which California conforms, the amount of an employer's contribution to an accident or health plan for the benefit of the employee or the employee's spouse or dependents is not includable in the employee's gross income.

Existing federal and state laws allow ordinary and necessary business expenses to be deducted, which would include health care coverage premiums paid by an employer for accident or health plans for employees.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

05/21/2001

Existing federal and state laws allow self-employed persons to deduct from gross income 60% of amounts paid during 2001 for health insurance for themselves, spouses, and dependents. The self-employed health insurance deduction increases to 70% in 2002 and 100% in 2003 and thereafter.

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Current federal and state laws do not provide tax credits for any health care costs. Prior state law would have provided a small-employer health coverage tax credit (SB 2260, Ch. 1521, Stats. 1988). However, that credit was repealed before it became operative.

THIS BILL

This bill would provide a credit for amounts paid or incurred by an eligible employer (including a self-employed individual) to provide health coverage for an eligible employee and that employee's dependents. To qualify for the credit, an eligible employer must employ on the average no more than 25 employees during the preceding calendar year. The employer must make participation in health coverage available to all eligible individuals at least annually.

Also, an eligible employer must pay or incur at least one of the following for an eligible employee who elects to have that coverage:

- 100% of the monthly premium for health coverage provided by a health maintenance organization; or
- 80% of the monthly premium for health coverage provided by a preferred provider organization or a point-of-service plan contract.

This bill defines several terms, including "eligible employee," "eligible employer," "health coverage," "dependent," "health maintenance organization," and "point-of-service plan contract."

This bill specifies the amount of the credit would be one of the following for employer-provided health coverage during the taxable year:

- 10% of the total amount paid or incurred for employee-only health coverage; or
- 20% of the total amount paid or incurred for employee and dependent health coverage.

This bill specifies that no deduction would be allowed for the same amounts for which the credit was allowed.

Any excess credit may be carried over for the seven succeeding years until exhausted.

This bill specifies the Department of Managed Health Care must forward to the Franchise Tax Board (FTB), upon request, a list of all health care service plans that provide coverage for basic health care services and are licensed under Chapter 2.2 of Division 2 of the Health and Safety Code. The Department of Insurance must forward to FTB, upon request, a list of disability insurers that provide coverage for hospital, medical, or surgical expenses and that are authorized to transact disability insurance in this state.

This bill specifies the FTB may prescribe regulations as appropriate, including regulations to specify what constitutes restructuring for purposes of meeting the 25-employee limitation.

IMPLEMENTATION CONSIDERATIONS

The bill uses the term "preferred provider organization" but does not define it. Also, it is unclear if a "fee for service plan" would qualify the taxpayer for the credit. The absence of definitions could lead to disputes with taxpayers and would complicate the administration of the credit.

This bill specifies that in order for an employer to qualify for this credit, participation in a health plan must be made available to all eligible individuals at least annually. The FTB has no practical way to verify that the employer has fulfilled this requirement.

TECHNICAL CONSIDERATIONS

Amendment 1 is provided for clarification purposes.

Amendment 2 is provided to correct a typographical error.

LEGISLATIVE HISTORY

AB 39 (Thomson and Campbell, 2001/2002) proposes a refundable tax credit to an employer for providing health coverage for certain employees and their dependents and is currently in the Assembly Revenue and Taxation Committee.

SB 719 (Poochigian, 2001/2002) proposes a tax credit for health insurance paid by the taxpayer for any member of the taxpayer's family that is eligible to receive benefits under the Healthy Families Program and is currently in the Senate Revenue and Taxation Committee.

AB 1734 (Thomson, 1999/2000), which also proposed an employer provided health insurance premiums refundable credit, failed passage in Assembly Appropriations.

AB 1262 (Campbell, 1999/2000), which proposed an employer provided health care coverage credit, failed passage due to missing the deadline for passing out of the house of origin.

AB 1172 (Frusetta, 1999/2000), AB 2520 (Prenter, 1997/1998), and AB 148 (Frusetta, 1997/1998) each proposed an employer provided health care credit for farmworkers, and each failed passage in the first policy committee.

OTHER STATES' INFORMATION

The laws of the following states were reviewed because of similarities to California's income tax laws.

Illinois allows self-employed taxpayers, partners in a partnership, and shareholders in S corporations a deduction for amounts paid for health insurance or long-term care insurance for the taxpayer or the taxpayer's spouse or dependents.

Florida, Massachusetts, Michigan, Minnesota, New York and Texas do not allow a health care credit.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill is not expected to significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

This bill would result in revenue losses as follows:

Estimated Revenue Impact of AB 694 As Introduced February 22, 2001 \$ Millions		
2001-02	2002-03	2003-04
-\$35	-\$115	-\$190

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

The revenue impact of this proposal would depend upon the number of employers who would incur qualified health-related expenses for qualified employees, the average costs of qualifying expenses, and the tax liabilities of employers. The health care, disability insurance, and labor market data were obtained from the Employment Development Department and other industry sources.

It is projected that about 25% of employees are receiving or will receive health coverage for themselves and another 15% for themselves and their dependents. About 60% of the insured employees were assumed to be covered under HMOs. Appropriate coverage costs for these categories were obtained, and were projected into the future, using information from industry sources. It was assumed that 50% of employers pay 100% of the coverage for the employees who choose HMOs, and 50% pay at least 80% of coverage for the employees who choose other coverage. An employer incentive effect due to the credit was factored into the estimate. The incentive effect results in the rapid increases in the revenue impact of the credit in the later years.

For the disability insurance provision, publicly available information indicated that about 45% of employers who offer health coverage also offer disability insurance. Moreover, 10% of employers who do not offer health insurance do offer disability insurance. An average disability insurance premium was obtained from industry experts. An employer incentive effect was also assumed for this portion of the bill.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 694
As Introduced February 22, 2001

AMENDMENT 1

On page 3, line 4, strike "the first sentence" and insert:

clause (i)

AMENDMENT 2

On page 3, line 38, strike "am" and insert:

an